ORGANISATIONAL CONTROL AND ENGLISH COMMERCIAL BANK LENDING TO INDUSTRY IN THE DECADES BEFORE WORLD WAR I

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RESUMEN

Los años 1880-1914 fueron de crecimiento institucional y de sistemática consolidación en el sector bancario inglés. A principios del siglo XIX se produjeron una serie de crisis que afectaron seriamente a los bancos de Inglaterra y Gales. Una de sus consecuencias fue generar preocupación sobre la liquidez de los bancos, planteándose simultáneamente interrogantes sobre la adecuada composición de los créditos al sector privado. El artículo examina los procedimientos utilizados por los bancos para minimizar los riesgos y estudia algunos aspectos de las prácticas crediticias que se aplicaron en las regiones más industrializadas de Gran Bretaña. En la primera parte se resume la organización y los métodos de control adoptados por las principales sociedades anónimas bancarias. La segunda presenta un esquema para la evaluación y seguimiento de los créditos. Y la tercera analiza las prácticas de los bancos en sus préstamos al sector industrial.

ABSTRACT

The years 1880-1914 were years of institutional growth and systemic consolidation for English banks. In the early and middle decades of the nineteenth century there had been a number of crises which had affected the banks of England and Wales. Ono effect was to raise anxieties about the liquidity of bank balance sheets, including fundamental questions about the composition of lending to the private sector. In particular, the paper discusses the procedures used by the banks to minimise risk and examines some aspects of actual lending practice as it applied to the industrial regions of Britain. There are three parts to the paper. The first briefly summarises the organisational and control structures that were introduced by the large joint-stock

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banks to standardise lending at their numerous branches. The second section introduces a schema for the assessment and monitoring of loans, and the third discusses some of the banks' pre-1914 practices with regard to loans to industry.

INTRODUCTION

The years 1880-1914 were years of institutional growth and systemic consolidation for English banks. In the early and middle decades of the nineteenth century there had been a number of crises which had affected the banks of England and Wales. One effect was to raise anxieties about the liquidity of bank balance sheets, including fundamental questions about the composition of lending to the private sector. In particular, the crisis of 1878 occurred after a prolonged period of industrial difficulty and, within the banks themselves, raised concerns about the extent to which industrial loans were illiquid and unmarketable —over-committed to particular firms, or sectors, and committed for too long a period. In contrast to these earlier troubled times, by the beginning of the twentieth century English banks were extremely stable, with possibly the most stable banking system in the world at the time. Obviously, a number of factors contributed to this stability— not least, the growth of scale of banking firms, the greater spread of risk achieved through bank amalgamations and the extension of branch networks, and (in the form of the Bank of England) the existence of an effective lender of last resort —but this paper concentrates on just one of the central issues: the policy adopted by the commercial banks themselves in their lending to industry. In particular, the paper discusses the procedures used by the banks to minimise risk and examines some aspects of actual lending practice as it applied to the industrial regions of the Britain.

We should make it clear at the outset that the article does not add to what we know of the scale of lending, nor of its division between short-term, and long-term lending through rolled over overdrafts. Those have been dealt with in a different ways elsewhere [1]. Neither do we discuss further the assessment of individual customers and why banks refused loans, nor do we provide further detail on the practice of lending to industrial firms [2]. Rather the focus is on the changing internal organisation that was devised by a banking system undergoing change to cope with the changing

[1] See Capie and Collins (1992); and Capie and Collins (1991).

[2] See Capie and Collins (1996).

world of the late nineteenth and early twentieth century. This has necessitated an investigation of the day to day business in the banks and has been made possible by an extensive trawl through the archives of the major banks. However, there is not the space to detail all the cases we examined and instead the argument is illustrated with examples which are representative of what was generally the case.

It seems appropriate too to make the point that contrasts have long been made between bank lending in England (or the Anglo-Saxon/Anglo-American model as it is sometimes called) and the system that prevailed in much of Europe, a system usually called universal. In the former the emphasis is on short-term lending and in the universal, as the name implies, it is said to be charterised by commercial and investment banking and by long-term commitment and long-term lending with improved information flows and so on. The debate on the relative merits of these systems has run for a long time and many refinements made to the original positions. A full and recent discussion of this can be found in Collins [3]. There is also some literature on the internal structure —governance— of the two respective systems. But there is a much more limited literature on organisation and control.

There are three parts to the paper. The first briefly summarises the organisational and control structures that were introduced by the large joint-stock banks to standardise lending at their numerous branches. The second section introduces a schema for the assessment and monitoring of loans, and the third discusses some of the banks' pre-1914 practices with regard to loans to industry.

ORGANISATIONAL STRUCTURE

In the decades from the 1880s to the 1920s commercial banking in England and Wales underwent a major process of market concentration, concomitant with an unprecedented increase in scale for the largest banking companies. The system as a whole was transformed from one consisting of numerous small, local or regional banks to one dominated by a handful of national giants [4]. Thus, between 1875 and 1913 the number of banks fell from 358 to seventy, yet the number of offices multiplied from 1,959 to 6,573. More significantly, the share of the biggest five banks in total

[3] See Collins (1998).

[4] Collins (1994).

domestic deposits in England and Wales almost doubled, to just under 41 per cent by 1913. By this date the «Big Five» had deposit liabilities of £419.5 million and proprietors' capital funds of just under £33 million. By 1920 these five banks were responsible for some 80 per cent of total deposits.

As a consequence the banks' internal managerial and control systems underwent a bureaucratic revolution [5]. Such expansion and institutional change challenged old systems of management and control and evoked radical overhaul of old practices. Effective control depended critically on sound accounting practice and Richard Sayers, the historian of Lloyds Bank, provides some telling insights into the nature of the challenge made by these changes to established managerial practices [6]. Lloyds was originally a family firm based in Birmingham, but it was a leading player in the amalgamation movement before World War I when it emerged as one of the biggest banks in Europe. When Lloyds became a joint-stock company in 1865 and embarked on a programme of expansion, new accounting procedures were required, but they initially resulted in total confusion. One of the partners, Howard Lloyd, describes how: «From the Managing Director down to junior clerks no one had the slightest idea how to work the new ledgers on the progressive system or how to start or carry on proper entries in the new... books.» For two weeks neither the ledgers nor the London account could be checked as it proved impossible to strike an accurate balance! This is a graphic illustration of the transformation that was required of the banks, of how major institutional growth necessitated the introduction of new and effective control systems.

One of the constituent banks that was eventually merged into Lloyds, the Gloucestershire Banking Co. (founded 1831, absorbed by Capital & Counties in 1886) provides an illustration of the other types of internal changes being introduced at this time. The Gloucestershire Bank developed a branch network of its own and during the 1870s and 1880s introduced internal reforms to cope with an increasingly diffused organisation. Local managers' discretion was curtailed and greater central scrutiny of lending was introduced. In 1882 the first set of rules on lending was printed internally, though the extent of its novelty as a tool of central management

[5] Hertner and Pino (1998), provides a valuable summary of the historical literature on the evolution of the organization of the firm, particularly as applied to banks. The important general literature includes Chandler (1962); Chandler (1992); Willamson (1981); Nelson and Winter (1982).

[6] Sayers (1957), pp. 232-40.

is highlighted by the following entry two years later in the Directors' Minutes: «It [has] been brought to the notice of the Board that the rules recently printed and distributed among the Managers of the several Branches for their guidance had been frequently disregarded.» It seems that at that time the concept of central control was indeed a novelty. At the same time head office's determination to impose standardisation and control is clear in the threat that «... the Weekly Committee be authorised to dismiss any manager who after this notice wilfully fails in... observance [of the rules]» [7].

Sayers general view of the changes that were occurring at many of the constituent banks of Lloyds was that by the last quarter of the nineteenth century there was 'considerable centralisation of lending power', with the greater use of accountants, auditors and inspectors producing an increasingly tighter system of control. At Lloyds Bank itself the initial means of inspecting the branch offices had relied solely upon the company's accountants conducting a half-yearly visit to check the ledgers and cash balances. But this proved inadequate as the number of offices began to mushroom and, as early as the first half of the 1870s, regular branch inspection had become incorporated into central office managerial responsibilities. By the 1890s there existed a team of inspectors to check all aspects of branch work, including the scrutiny of bills, securities and doubtful debts. Head office managerial responsibilities had also been separated into different functions, with a specialist Advance Department set up in 1879 to supervise lending at all bank offices.

Another Birmingham-based bank, the Midland Bank, also had close connections with the business community. However, from its beginning in 1836 (as the Birmingham & Midland) it had been a joint-stock bank. It underwent rapid expansion and transformation (like Lloyds, mainly through the acquisition of other banks) in the decades around the turn of the century. In 1885, proprietors' capital stood at £0.6 million and there were just ten branches and eighty staff; in 1900, capital stood at £5 million, with 314 branches and 1,500 staff; and by 1918/20 (when by some measures the bank was the largest in the world) capital was £14 million, with 1,497 branches and 10,697 staff employed [8]. This made it not just one of the largest financial institutions, but one of the largest business organisations from any sector at that time.

[7] Sayers (1957), p. 234.

[8] Holmes and Green (1986), Appendices.

At the Midland Bank, managerial response to keeping control over the lending was similar to that which occurred in the constituent banks of Lloyds, with the autocratic chief executive, Edward H. Holden, favouring a strict, centralised regime. After merger most of the absorbed banks quickly lost their autonomy and were incorporated into the Midland's control and managerial structures. «The expansion of staff numbers required uniform division of managerial and clerical duties and full protection against fraud, petty misdemeanours or mere slackness» [9]. At managerial level, the lines of responsibility and communications went from branch managers to the three general managers at head office in London. «From the late 1890s Midland's branch managers worked to standardised regulations and procedures, continually updated by new instructions and circulars... the main adjustments were in the evaluation of securities and bills and in the handling of bad and doubtful debts» [10]. From the turn of the century all loans over £2000 (worth about £85,000 now) had to go to the central board of directors for approval. As Holmes and Green show, this actually raised the existing ceiling on the branch managers' discretion over loans. Thus, amongst the Midland's constituent banks, the City Bank's ceiling on managers' discretion before take-over had been £500 or £1000 in the 1890s; in the London Joint Stock Bank it had been £1000 (£300 on unsecured loans); and in both the Leicestershire Banking Co. and the N & S Wales Bank, all loans —irrespective of the amount— had had to be approved centrally.

Thus, the banks managed the threat to control posed by the sharp expansion of the scale of their business by standardising rules on lending, circumscribing local managerial discretion (or, at least, formalising control over it), and by centralising decision-making and supervisory procedures. But the derivation of the stability of the system of bank lending went deeper than this. It depended ultimately on the fact that the English commercial banks ensured that the process of lending was a relatively simple task, upon the inculcation of routine practices which minimised risk and assured portfolio liquidity. The scope of such practices can perhaps be best illustrated by reference to the detailed operation of industrial loan accounts, for it was such loans to industrial firms which had been a source of illiquidity and high risk in the past.

[9] Holmes and Green (1986), p. 111.

[10] Holmes and Green (1986), p. 112.

THE PROCESS OF ASSESSING AND MONITORING BANK LOANS

Before looking at the findings from the archival research, it will be useful to remind ourselves of the essential elements involved for a bank in making loans to the business sector.

For analytical purposes it is possible to identify five main stages involved in the process used by bankers for assessing and monitoring industrial lending, for the gathering and evaluation of data for subsequent decision-making [11].

I. Acquire Information on Borrower

- background information (private enquiries and published material)
- check available financial statements
- assess «credit-worthiness» (e.g. set upper limit to which bank prepared to go)

II. Acquire Information on Loan

- client's request re. value of loan
- intended purpose
- means and proposed method of repayment

III. Assess Risk

a) *Risks associated with firm; prospects for repayment?*

- general assessment of partners or directors—personality, personal wealth and degree of involvement with firm
- judgement on ability of firm's current management
- evaluation of future commercial performance of the firm itself
- assessment of prospects for industrial sector in which firm operating

[11] For a fuller version see Eisenreich (1981), pp. 2-13. Also see Stanga and Benjamin (1978), pp. 17-21: And Berry, Citron and Jarvis (1983), pp. 27-55.

b) *Risk attached to security; how realisable?*

- type of security offered?—personal, marketable or not?
- valuation of security
- margin between sum lent and value of security
- legal nature of bank's claim to security in case of default —determine claims of other creditors, e.g. debentures outstanding, mortgages?
- bank's claim to client's other assets in case of default

IV. Agree Terms of Loan

- within branch jurisdiction or determined at divisional/head office level?
- settle terms-size, duration, rate of interest

V. Monitor Operation of Loan and Reappraisal

- how conducted and by whom?
- what happens if things go wrong? —application of correctives and-sanctions by the bank. [How supportive, how punitive?— factors determining response?]

Historical practice will have differed from this stylised model in various ways and, certainly, operations on individual accounts will have differed in detail. In fact, two or more phases could well have overlapped or been omitted all together. Also, it is clear that some aspects of this form of information-gathering and assessment procedure would have been more applicable to new applicants than to existing clients with an established track record. Nevertheless, the use of such a normative model helps focus more clearly on the essential components of the pre-1914 decision-making process on industrial loans and it provides a standard framework within which to examine the complexity of circumstances and interactive decision-making involved on individual accounts.

OPERATION OF LENDING IN THE INDUSTRIAL REGIONS

This section of the paper is based on archival research which has been conducted jointly by Forrest Capie (City University Business School) and

Michael Collins (Leeds University Business School) [12]. First, a summary assessment is provided and, then, this is illustrated by reference to a number of specific cases. By the end of the nineteenth century, the process by which loan applications were appraised and subsequent movements on the account were monitored was already well-established, standardised and systematic. In the first instance it was the responsibility of the local manager to assess each application for a loan. But as we have seen, his discretionary powers were circumscribed. In cases above the discretionary ceiling imposed by his organisation he had to make an initial assessment, with a recommendation to regional or head office who took the eventual decision. Subsequent monitoring of the account followed the same pattern, with the branch manager collecting information and making regular reports to his superiors, and it was his responsibility to alert senior management to any problems on the account.

A «private memoranda» book was used for the regular upgrading of the local bank manager's information on industrial clients and it was in that that he recorded his assessment and credit rating of clients. This study draws heavily on these contemporary, confidential records which reveal details of the operation of accounts, including explanations of decisions over lending. The purpose of the private memoranda was twofold. In the first instance they served as an *aide memoir* for the bank manager who had to deal at irregular intervals with a large number of customers. He needed to be able to look up a particular client in the index and refresh his memory about previous interviews and correspondence and about the details of the client firm's business. Because of this, the private memoranda books constitute, in effect, a record of all communications between manager and customer, together with any private thoughts the manager might have had on the financial position and prospects of firms which were important enough to note down. Their second function arose out of managerial control requirements within the banks. Towards the turn of the century, the use of the same type of private memoranda books by the increasing numbers of local branch managers employed within the one bank was part of the internal efforts of the more successful, large multi-branch banks to increase

[12] The results reported in this article are part of a larger project financed by the Economic and Social Reserch Council —ref. R000232220: «Commercial Banks and Industrial Finance in England and Wales, 1850-1914», which is jointly supervised by Michael Collins and Forrest Capie. We are particularly grateful for the help and encouragement of the Midland Bank plc. National Westminster Bank plc, Barclays Bank pls, Lloyds Bank plc and the Royal Bank of Scotland plc, and we are indebted to Judith Wale and Phillip Hunt who were employed on the project to conduct the archival work.

and standardise the degree of control exercised by the organisation's central management from head office (or from a centralised loan department). For this reason the books also provide a record of communications between local manager and head office. It is in this capacity that they also provide insights into policy on bank lending to industry.

We have built up an extensive data set of information on over 3,000 individual industrial accounts, drawn from internal, confidential records of the operations at 268 separate branches of twenty individual banks (with particular use of the records of Lloyds Bank and the Midland Bank). These relate to both existing customers and approaches from prospective customers. Although the period for which records are available on individual industrial accounts differs a great deal, for many it has been possible to follow operations over a number of years, sometimes decades. In aggregate, the private memoranda material covers the years, 1866-1914, and the coverage is such that the resultant sample may be taken as representative of the sort of industrial lending being made by English commercial banks in the provinces at that time. Overdrafts of all sizes are included, encompassing a wide range from small businesses with a single proprietor to some of the largest companies of the period. The localities included in the study were drawn mainly from the industrial heartlands of the midlands and north of England, although some of the accounts were based in London, Wales and on the south coast. In sum, it has been possible to compile rich detail on a sample of industrial accounts in the west, east and north Midlands, Lancashire, Yorkshire, and the north-east of England —with supplementary material on South Wales.

The records show that, in most circumstances debit accounts were reviewed at least once a year. This was a consequence of the fact that loans were formally granted for short periods. Thus, from the period, 1880-1914, less than five per cent of our sample of loans was granted in the first instance for longer than twelve months. Therefore, continuation or renewal of a loan created frequent opportunities for the bank to re-appraise the client's credit and the terms of the loan. As with an initial loan application, the local manager would gather together the information and make a report to head office for these reappraisals. The manager's information was derived from a variety of sources though, obviously, straight-forward, direct questioning of the client, or senior representatives of the client firm —at interview and through correspondence— was almost a universal practice. Managers would normally try to obtain balance sheets and other financial accounts, and lists of company directors and shareholders where appropriate, either direct from the client or from any published source. Writing in 1885 in the *Journal of the Institute of Bankers*, T. B. Moxon had advised that: «The investigation of a balance sheet may be taken as a desirable preliminary to the granting of any accommodation to a firm...», and the internal records show that managers routinely followed this advice. However, success in obtaining informative financial statements depended greatly upon the status of the client. In the case of corporate clients few difficulties were encountered in gaining access to some sort of financial statement, but many sole traders and private partnerships did not employ an accountant or were not prepared to show the bank their accounts (even if such existed in any systematic form). Sometimes a bank insisted, suggesting an accountant if need be, but for such firms the manager relied largely upon information of a more general sort from his own contacts in the local community; perhaps from referees nominated by the client and acceptable to the bank; and newspaper and trade reports. Over time, the strong trend amongst industrial firms towards incorporation meant that, in fact, a banker's access to balance sheets became easier. As an indication of this it is worth noting that amongst our sample of industrial accounts, private firms outnumbered companies by five to one in the early 1880s, but by World War I the situation had been reversed and companies outnumbered private firms by more than three to one.

Information was assembled locally, but it had to be reported upwards to divisional or central headquarters, together with the local branch manager's recommendations on whether or not to lend, to what amount and on what securities. As we have seen, the decision was subject to formal approval from head office. The strength of the system lay in the central role it gave to local appraisal —to the local, specialised knowledge of branch managers— at the same time as ensuring that this was subject to central scrutiny and sanction. Within the bank, the branch manager, with his local contacts and regional knowledge, would normally be in the best position to assess the credit-worthiness of local businesses. Conversely, head office officials were best placed to ensure all loans complied with the banks' overall regulations and policy. Those regulations themselves and the long apprenticeship of managers ensured the thorough inculcation of the bank's established principles and practices on lending to businesses. The internal records show that branch managers were constantly reminded of current regulations, taken to task by head office or divisional superiors for the slightest breach, and obliged to justify in full any digressions from normal practice.

The concerns of the senior management were of *two* sorts: overall asset management; and conformity in the application of the rules. First, good asset management obviously set an upper limit to the proportion of a bank's total assets it was considered desirable to hold in a non-marketable form such as loans. On the one hand, this was a question of prudence and established banking conventions; on the other, it was a question of profitability. Trends in interest rates and the opportunities for the employment of bank funds in outlets other than loans to the business sector were important, but always within the overall constraint of the liquidity and prudent distribution of a bank's overall balance sheet [13]. Goodhart shows that at the London head offices of the major clearing banks there was close scrutiny of the overall ratio of relatively high-risk, earning assets —particularly the ratio of advances (loans and bills together)— to deposits [14]. As a matter of routine, every bank watched this earnings ratio carefully (with the Midland recording the ratio every week in its balance sheet) and generally it would seem that some concern would be expressed if the ratio of advances to deposits for the bank as a whole rose above 55 per cent, and positive alarm if the ratio should rise above 60 per cent for any length of time. It was in this area, of course, that large, geographically-dispersed banks such as the Midland had an advantage over smaller, less well-diversified banks whose ability to spread risks was constrained in that they were less able to balance branches with high «earning ratios» against those with low ratios. An article in the *Journal of the Institute of Bankers* of 1906 was even more conservative, suggesting a ratio of advances to liabilities of just 40 per cent. Our own calculations show that, in fact, this ratio for all English and Welsh banks averaged around 50 per cent from the middle of the 1890s onwards.

There is no evidence in studies such as those of Goodhart or in the primary sources we have researched, that contemporary banks drew any clear distinction in their overall asset management between loans to the business sector and loans to other parts of the non-bank private sector. Because of their greater liquidity attributes, loans to the banking sector and loans to government were treated differently, but all other private sector loans were generally lumped together for portfolio management purposes. However, there were some exceptions to this general pattern. Occasionally fear of undue risk or over-exposure in a particular sector did intro-

[13] Goodhart (1972).

[14] Goodhart (1972), pp. 156-58.

duce a discriminatory element within the central management of loans. For instance, the private memoranda suggest that difficulties in individual sectors led to some reluctance to provide loans for the promotion of new cycle companies in the aftermath of the 1896 flotation boom, and reluctance to lend to brewery companies in the early 1900s, partly because of declining profitability and partly because of impending legislation which threatened property values.

In addition to issues of overall asset structure, the second major concern of head office regulators was to ensure that the terms governing individual loans complied with bank regulations. Thus, local managers had to be meticulous in ensuring that the size of the loan, its duration, its purpose and the security offered by the borrower all met normal criteria. He (with the aid of a solicitor or accountant if need be) was also responsible for checking on the legal standing of the borrower, for establishing legal responsibility for meeting repayment (potentially more complicated in the case of corporate clients than private partnerships with unlimited liability), and for checking the status of any collateral being offered. Regulations governing such matters were frequently updated and regularly communicated to all managers. On occasions, head office was willing to bow to special pleading from the branch manager for a variation of the normal rules if there were peculiar circumstances pertaining to the client, but this was only allowed if the manager could demonstrate that the bank's interest were nonetheless fully protected (e.g. through the provision of adequate collateral). Rarer still, were cases where dissatisfied clients by-passed the local manager and negotiated direct with head office —an option that would be feasible for only the largest clients with influential directors or partners.

On the other hand, head offices very rarely contradicted the advice of local managers. We interpret this as a measure of the success of the process of control and standardisation, with branch managers aware of and strictly applying corporate rules and, thus, operating as an effective local filter before requests reached senior management. Managers were in no doubt as to what constituted an acceptable loan and they would normally refuse to send up to head office a client's request which they knew to be in breach of the standard rules. It also seems a reasonable assumption that in such circumstances, most business people —i.e. the borrowing client— would have been conversant with what form of accommodation their banker would and would not normally countenance. Thus, *prima facie*, we would not expect records to reveal many requests from industrialists for fixed capital funding, or for loans over very long periods, or for the provision of mortgages, as it was widely known that commercial banks did not provide such a service. Indeed, other results from this project show that, in fact, this was true —industrialists rarely sought such loans from their bankers [15].

The application of these general principles can best be illustrated by reference to the actual operation of a number of accounts. First, two industrial accounts held at Lloyds Bank. It is clear from these that a feature of contemporary bank practice with respect to industrial loans was the frequent (once a year) sight of a client firm's balance sheet by the bank manager and the submission of his subsequent appraisal to head office. Balance sheets were also frequently requested before deciding on an extension of an existing overdraft limit. Both individual examples provide some insight into the use made by the banks of clients' balance sheets.

The first of these accounts was held at the Birmingham Five Ways branch of Lloyds by Hunt & Mitton, a general engineering firm [16]. The account was opened in November 1881 and by January 1882 there was a general overdraft facility of £200. Over the following three decades, this limit was the subject of fairly frequent re-negotiation (generally in an upward direction) and it stood at almost £4,000 by the end of the century. Audited balance sheets were part of Hunt & Mitton's bargaining counters when negotiating increases to the loan. When the business was strong the engineering firm used its balance sheet to support the case for the continuation or extension of bank credit. Indeed, this was regular practice through the 1880s. On a later occasion —in May 1900— the bank was initially reluctant to grant the firm's request for an increase but was persuaded by the presentation of favourable detailed, audited accounts. Indeed as a private partnership (and, early in the history of the account, as a sole trader), the client firm in this case would seem in normal circumstances to have had the upper hand over the bank in that the public provision of balance sheets was not a legal requirement, Hunt & Mitton did not always strike one (or, at least, claimed not to have done so) and, thus, in response to enquiries from the bank they could inform the manager that precise financial information was not always available for his inspection, or simply fail to show it to him. In fact, the bank manager was ever conscious of the sensitivities of private partners to too much meddling in their affairs. In reality, much depended on the circumstances and the relative balance

[15] Capie and Collins (1996), pp. 26-44; and Capie and Collins (1999).

[16] The archives of Lloyds TSB plc —ref: Birmingham Five Ways, 1881-1913, LBA/B477a/4-6.

of negotiating strength between the bank and client. When the client was keen to keep the bank «sweet», detailed accounts would be proffered. Thus, when the bank was being asked to consider a new or extended loan the bank might ask to see a recent balance sheet. In more normal circumstances, however, the bank felt unable to press for such information.

The regular production for bank perusal of annual balance sheets was common throughout the 1880s on the account of Hunt & Mitton whenever the firm sought more bank accommodation. From these, the bank manager reported to head office the composition of assets and liabilities, recorded the profit and loss and, from the working of the bank account, could easily see the turnover of the firm's business. For instance, the manager noted the following in a typical entry (in this case for April 1885):

> Balance sheet for 31.12.84 showed £3100 capital, £217 overdraft, £150 patterns, £738 plant etc. Profit for year £974; they had made ample allowance for wear and tear and had written down the plant and stock (and increased the patterns) to such an extent that under the hammer they would fetch at least the balance sheet amounts. All bad debts written off.

However, the bank manager did not rely upon accounting information alone. Again, much depended upon the relative strength of the bank's and client's negotiating position of the moment. Interviews with the partners were normal when an extra loan was required (and the bank had a stronger hand to play), and the manager did discuss the detailed valuation of assets submitted by the firm. In December 1887, for instance, Hunt & Mitton were seeking a short-term overdraft of £500 to enable them to purchase the lease on their works. The firm had claimed to have spent £1000 on the works, but Lister, a senior executive from the Advance Department of Lloyds, undertook a site visit and raised doubts about the firm's own valuation, believing the works to be worth no more than £600. On this basis he recommended a loan of £400 but, significantly, it was left to the local manager himself to make the final decision. In this case, £500 —the amount the client was seeking— was advanced, with the deeds of the works being deposited with the bank.

To summarise, balance sheets were, thus, routinely used on the account whenever available, but in the case of private partnerships the information was not always available and, when it was, the bank was prepared to base its judgement on a wider consideration of the client's circumstances.

The second illustrative case focuses on how the regular scrutiny of balance sheets could alert the bank to possible difficulties. The account was that of the Leeds Engineering & Hydraulic Co. Ltd. which ran into some problems and began to draw heavily on the local branch of Lloyds Bank [17]. The troubles of the firm were not discussed in the records in detail, but the bank was very anxious not to extend the limit of its own commitments and, ultimately, restricted it own involvement. The entries on the account for 1900-1902 show that the bank was lending the firm some £800 and the bank manager's examination of the annual balance sheets led him to the conclusion that the firm was under-capitalised. Profits were very poor and he felt that there had been inadequate allowance in the accounts for depreciation. The balance sheet figures, thus, suggested that bank accommodation should be cut unless the firm could arrange an infusion of new capital.

The firm itself was seeking a long-term solution through the issue of shares and incorporation as a limited company [January 1902], and the bank was persuaded to continue the loan until the additional equity was raised. In December 1902 the new company was duly registered with £25,000 of ordinary and preference shares, and £10,000 of debentures. Part of the capital was used to pay £2,500 off a mortgage debt. The bank manager insisted on full information on these arrangements and he passed them on to his head office. Only on the basis of this satisfactory financial information was the bank prepared to offer the new company an overdraft facility for £1,000. [April and August 1903]

Both these accounts reveal the importance of balance sheets, frequent reviews, and the local manager's judgement at different stages of the screening and monitoring process outlined in section two. They also show clearly how the system of local knowledge and centralised control operated in practice. This was a system that arose naturally from the form of growth chosen by the English banks —expansion through acquisition. It enabled the predator bank to acquire a series of smaller banks and their existing network of branches and branch managers with local knowledge. It would have been much more difficult if, say, expansion had been sought through the establishment of brand new branches, set up in direct competition to existing local banks. In this hypothetical case, there would have been a serious constraint on the supply of candidates with suitable status and adequate local knowledge and connections to make a good branch manager.

[17] Lloyds TSB plc-ref: Leeds, 1900-14. BA/B793a/3-9).

INFORMATION ON THE BORROWER

The banker's assessment of the character and wealth of the borrower was the starting point for all decisions on lending. Judgement as to the extent of the client's asset holdings, indebtedness, business acumen and integrity were obviously central to whether the bank was willing to grant a loan, and to the size, type and duration of that loan. For the initial assessment —say, when an account was opened, or a loan requested for the first time— the manager depended in the first instance on his knowledge of the local business community and upon information from his own business and social contacts. This would be supplemented with information from the client and —especially if the firm was active outside the locality— from the bank's other offices and other sources of information such as newspapers.

As has already been suggested, the client firm's legal status was critical to the evaluation. In the case of sole traders or partnerships with unlimited liability, the firm's identity and available assets were synonymous with those of the partners. In the case of corporate clients, assessment of the wealth and character of leading directors, shareholders and managers was conducted in a similar manner, but in these cases particular regard had to be paid to the legal status of the company, the extent of proprietorial liability and the potential claims of other creditors (e.g. debenture holders). In those days of personal capitalism, undoubtedly a good part of such evaluations was necessarily subjective (though this is not to suggest that such an element does not continue to be important in today's decision making). However, within the context of the amount and quality of information available, all the banks in the study appear to have operated in an impartial manner. If the outcome of the assessment of the client's assets was favourable, then loans were available (subject only to the normal, standardised criteria).

In making such judgements there was no apparent prejudice, for instance, against any particular type of business activity or sector. No one sort was favoured over another (given the same conditions regarding size, available information, and so on). Thus, there are many illustrations of loans to new forms of activities —loans to new firms and for the financing of new products by both established and new firms (e.g. in the machine tool, electricity, cycle and motor vehicle sectors)— as well as loans to firms in established sectors following well-established. Similarly, there was no apparent bias against any particular form of business enterprise —sole trader, partnership, private company, public company, with limited and unlimited proprietorial liability— although details of securities and collateral taken could differ from one type to another depending upon the relative legal positions. In fact, the private memoranda material shows that, around the turn of the century, a number of the larger banks were actively engaged in the process of launching new corporations and converting established partnerships to limited companies. In these cases, bank involvement might take the form of loans to finance the operation, with some general advice on the launch but never the underwriting of issues (which was left to specialist institutions) nor the purchase of equity.

The main exceptions to the absence of discrimination towards particular sectors or types of firm were on those occasions when the bank judged that the business environment in which certain sectors were operating was particularly unfavourable. As was noted earlier, there was a great reluctance to take on new cycle company customers in the aftermath of the 1896 surge of company flotations and overvaluations in that sector. Even here, though, existing cycle company clients were afforded their customary loans to allow for the winter season of stock building. Similarly, in the early 1900s there was also an unwillingness to lend to breweries on the security of mortgages of licensed properties, particularly in the years when impending legislation created uncertainty over the future of some properties. This policy decision was also against the backdrop of poor profits performance for many of the brewery companies. Another example of industry-specific discrimination is the Midland Bank's reluctance to lend for more cotton mill construction in Lancashire just before 1914 because of fears of over capacity. Also in the case of the Midland, Holmes and Green suggest the bank was reluctant to lend to collieries at the turn of the century because of previous bad debt performance [18]. In other words, the banks were not prejudiced in any irrational way, in all the examples the perceived increase in risk was based on a rational assessment of market prospects.

One factor that could make a difference to the bank's attitude during the detailed operation of an account was the relative size of client firm and of its loans. Not surprisingly, the wealthy and influential were more likely to encounter bank tolerance to small indiscretions in the operation of the account. Indeed, small, troublesome accounts seem to have been most vulnerable to adverse decisions being taken by the bank. In such

[18] Holmes and Green, 117.

cases, the potential loss was easier to absorb than on a large account and —all things being equal— the bank was inclined to be harsher when difficulties arose, insisting on adherence to prior agreements and, perhaps, calling in a loan.

At the other end of the spectrum, a large well-established company or businessman tended to be treated more leniently. This was particularly true of the very large industrial firm on whose account the bank felt there was no danger of reneging on commitments. In such cases, the rules might not be applied as closely as normal (e.g. the bank might be afraid of causing offence by asking for a balance sheet statement from a very wealthy client who was used to seeing the affairs of his business as a personal or family matter). For the bank, of course, it would not be primarily a matter of etiquette, but of profit. Offence in such circumstances might not only lead to withdrawal of the (large) account but to threats to other business if the wealthy account holder let his connections know of the bank's attitude.

The banks in the study routinely made use of information in an effective and professional manner for both the initial scrutiny of requests for loans and the subsequent monitoring of accounts. A bank's decisions on lending on a particular account depended critically on the amount and quality of information available to it. This was obviously true not only for its overall judgement of the client's credit-worthiness but also for recurrent decisions on loan requests. The bank was fundamentally concerned with the client's ability to service and repay the debt, but this almost invariably encompassed a judgement by the bank manager as to the client firm's commercial viability. As has already been stressed, there was regular use by the banks of financial accounts, especially balance sheets, with particular regard to the valuation and marketability of assets, the client firm's gearing ratios, the size and form of debt (debentures, mortgages, bank loans, etc.), the amount of uncalled capital, the amount of undistributed profits being ploughed back into the business by partners and directors, the profitability of the business, and practice regarding the payment of dividends relative to current earnings.

Site visits were organised if appropriate but these were rare. When they did take place they were used by the manager or the bank's valuer to assess the value of assets (e.g. buildings and machinery) and, perhaps, to make a more general judgement on the organisation and prosperity of the concern. Sometimes, if the client firm was seeking a large or unusual loan relative to its assets, or if the bank had some anxieties about the client's ability to meet the terms of the loan, the manager might use the opportunity afforded by such a visit to go through the firm's accounts. In some circumstances, however, customers were prepared to supply only the minimum of information and caution would oblige the bank to restrict the extent of its commitments. In the case of wealthy private partnerships, once again a delicate touch may have been required from the manager if offence was to be avoided in circumstances where the concerns of family and firm intertwined and outside «interference» would not be tolerated.

Some of the issues are illustrated by the case of firm of Edwin Bostock & Co., boot and shoe manufacturers, which had an account with the Manchester & Liverpool District Bank in Stafford [19]. It was a family firm, a private partnership, where the legal liabilities and assets of business and family overlapped. The account was opened in 1878 when the capital in the business was reported by the client as £66,000 and at which time the firm was already «among the largest and oldest in the trade». [March 1883] It is clear from the records that the high status of the client and contemporary conventions regarding privacy and the acceptance of a gentleman's word, rendered it inappropriate for the bank to ask for (what was considered to be) confidential information. Thus, the bank had no detailed financial information about the client except for the workings on the bank account and any additional material volunteered by the family. In this case, the family offered the bank no additional information whatsoever. Instead, the bank manager had to rely on hearsay and personal contacts in order to update his information even in the most general manner. For instance, in March 1884 the manager felt obliged to enter into his official record of the account that he had learned confidentially from a leather merchant with whom he was acquainted that the senior partner of the firm had been worth £70-80,000 at the time of his recent demise. The standing of the family was so high in fact that, on the basis of this sort of vague, general information, the bank continued to meet fully the firm's request for an unsecured overdraft limit of £5,000. It was only in 1898 when the firm became a limited company «for reasons of convenience only» (with no shares being offered to public) that some formalised accounts became available which were then shown each year to the bank. [February 1898; March 1898] Henceforth, the manager reported the annual balance to head office, as he did for all corporate customers. The new limited company was granted the same overdraft limit as the private part-

[19] National Westminster plc-ref: 48, Manchester & Liverpool District, Stafford, 1879-1908. NWBA/6002,9097-8.

nership, £5000 (again, the amount required by the client), the only difference being that the directors (who no longer carried the same legal responsibility for the firm's debt as when it was an unlimited private partnership) had to sign personal guarantees against the amount. This, too, was a very common practice with respect to limited companies.

Another illustrative account is one at Lloyds Bank, that of an armaments firm, G. Kynoch & Co [20]. The records on the account cover the very long period, 1876-1914, which spanned the life-cycle of the firm from its early existence as a sole trader through its restructuring as a limited company which, by the beginning of the twentieth century, had grown into one of Lloyds' largest industrial clients in the midlands. It is thus possible to detail the bank's treatment of the client's lending requests under different corporate structures. The account was opened in March 1876 when the sole owner of the firm, George Kynoch, transferred the account from the Birmingham & Midland Bank. The bank manager was *told* that the balance sheet for December 1875 had shown a surplus of assets of £97,000 (a rolling mill had recently been bought for £6,000) —as was often the case with sole trader and private partnerships, this information was conveyed by word of mouth, no detailed accounts were presented for the manager's perusal. A turnover on the account of up to £300,000 was forecast, no bill discounting facilities were required but an overdraft facility was necessary. The bank agreed to an initial limit of £10,000 on the deeds of freehold and leasehold properties. Over the following eight years, in fact, the overdraft ranged from £10-25,000, more often than not at about £15,000. The bank's security continued to be deeds of property though most was also covered by Kynoch's personal guarantee. During this period the firm's status as a sole trader meant that the bank, apart from its own analysis from the working of the account itself, was obliged to rely upon the client for the provision of accurate financial information about the business. In fact, the production of balance sheets was irregular, essentially dependent upon whether Kynoch thought it was in his interests to show the accounts to the manager (say, when he was requesting more loans) and the balances that were produced were not independently audited. There is no suggestion of mis-representaion of the firm's position but obviously the circumstances meant the bank was denied regular access to relevant, verifiable information.

[20] Lloyds TSB plc —ref: 3, Lloyds, Birmingham Colmore Row, Armaments. 1876-1914. LBA/B360a/37-8, 40-51.

The type and supply of information to the bank changed when the firm was incorporated as a limited company in 1884. From the bank's point of view, incorporation meant it had more ready access to regular (half-yearly) balance sheet and profit and loss accounts. These appear to have been audited, but they were still only general accounts —there was no question of the bank having access to detailed financial information about the business. Incorporation also meant that the bank's security was enhanced by the increase in the number of shareholders, although this was offset by the limited nature of shareholder liability which had not applied to Kynoch when he was a sole trader.

With the creation of the new company, the terms of the bank account were re-negotiated. A normal overdraft limit of £15,000 (£700,000 in today's terms) was allowed against deeds provided that a sufficient margin of the company's share capital remained uncalled. If this were to be called up, however, the directors' personal guarantees would be required. This was typical of arrangements with limited companies —even if securities were held, the bank wanted the assurance that in the event of a liquidation there was either adequate shareholder liability (in the form of uncalled capital) or it could hold the directors legally responsible for the overdraft irrespective of the company's assets.

CONCLUSION

A number of general comments can be drawn from these, and the many more individual cases in our survey. As regards their lending to the industrial sector, English commercial banks coped with the tremendous institutional growth that they experienced in the decades before World War I by developing a structure which married together local knowledge with a tighter system of central control. As we have seen, given the conventions of the day and the persistence of personal capitalism, detailed information was sometimes difficult for the bank to come by in assessing and monitoring loans. This could have been a source of instability, especially as the lending business was not confined, as in some central European banks, to a small group of favoured industrialists well-known to the bank but, on the contrary, was relatively undiscriminating and open to virtually all businesses that applied and met the minimum requirements. Yet the system was very stable, and losses on bad debts were low. Undoubtedly, a major factor in the adopted assessment and monitoring procedures was that the rules governing all loans were kept simple, and standardised. In a simple manner it was this that facilitated both central control and ensured stability despite the size of the organisations involved, and the rapidity of the institutional change they underwent. It was this simplicity that minimised local decision-making as regards risk. It also minimised the requirement for detailed information about the borrower's business (which we have seen was not always available anyway).

What were these rules? Formally, only short-term loans were allowed. Their purpose was confined largely to credit, working capital uses (hence, arrangements were subject to frequent review). If there were any doubts, security was taken (usually to the same value as the loan). The specialised industrial knowledge required of the local managers was, thus, minimal —they could concentrate on general financial issues such as the adequacy of collateral. For the bank's asset structure, liquidity of private sector loans and overall stability were assured. Were there any drawbacks with this system? Judgement here depends on how one views the function of commercial banking. The English banks were extremely effective credit banks, they were definitely not investment banks.

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